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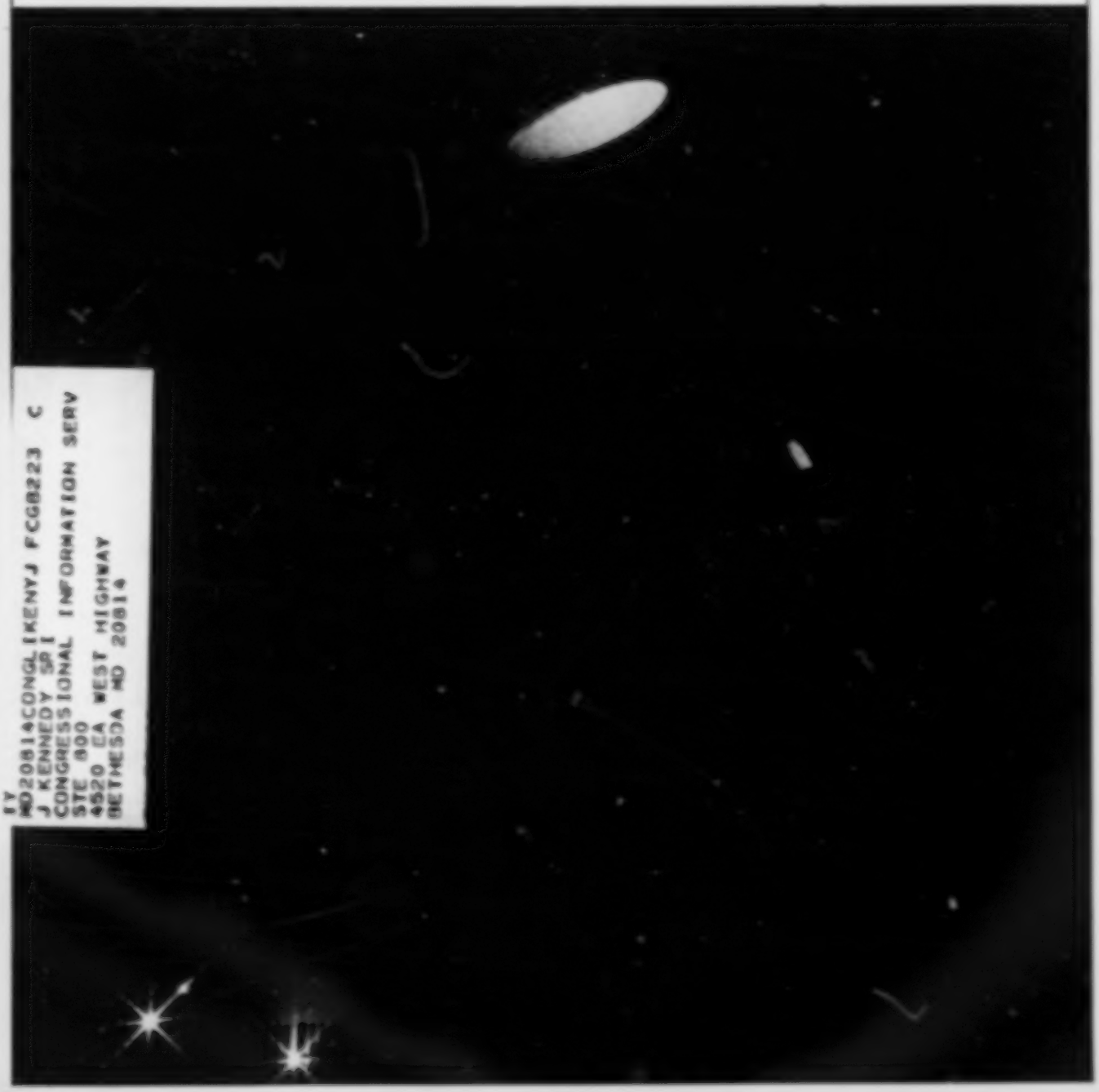

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The post-divestiture toll markets: a look at the shape and size

KENNETH R. DUNMORE

THE BREAK-UP of the Bell System has brought with it a change in the concept and structure of toll markets.

Prior to January 1984, the Bell operating companies (BOCs), Independent telephone companies and AT&T Long Lines together provided an integrated toll network of intrastate and interstate message toll services, (MTS), wide area telecommunications services (WATS) and private line services. With divestiture, this partnership has been dissolved. Pieces of the toll market now are distributed among the three partnership groups.

The modified final judgment (MFJ) in the American Telephone & Telegraph Co. (AT&T) antitrust case required the delineation of local access and transport areas (LATA) within which BOCs would be allowed to provide exchange, exchange access and toll services. Each state in which a BOC provided service, and there are 47 of them, was configured into one or more LATAs, with the exception of Delaware, which was in its entirety attached to the Philadelphia LATA. Independents were given the option of association with a BOC LATA for the purpose of providing joint services or forming an independent market area.

Intra-LATA services were made the nonexclusive domain of the BOCs. Inter-LATA services were delegated to interexchange carriers (IXCs), such as AT&T Communications (ATTC), MCI, GTE Sprint and the other alternate carriers. Service between LATAs in different states may be provided on a competitive basis as a result of various Federal Communications Commission (FCC) and court decisions.

Service between LATAs in the same state is the domain of ATTC, at a minimum. It is up to individual state regulatory agencies to decide on the merits of competition for inter-LATA services within the states. Similarly, although intra-LATA services are to be provided by the BOCs and Independents, state commissions also may permit competition in this market.

For the most part, LATA boundaries stay within state lines. In order to provide continuity of service, exceptions exist which cause LATA boundaries to cross state lines. These exceptions account for an incidental number of telephones and telephone traffic, with the exception of Delaware. Another exception to the general rules governing LATA boundaries is the provision of inter-LATA corridor traffic by BOCs, which are generally forbidden from serving inter-LATA traffic demands. Due to the high cost of network reconfiguration, the traffic in certain corridors which cross LATA boundaries was assigned to the BOCs. These exceptions include New York City to northern New Jersey and Philadelphia to southern New Jersey corridors.

Figure 1 presents a pair of hypothetical states to illustrate the nature of the intra-LATA and inter-LATA

Continued on page 74

Table 1
MTS messages and distribution
(000,000)

	Intrastate	Interstate
Intra-LATA	799.6 (47.3%)	28.1 (1.7%)
Inter-LATA	296.4 (17.5%)	567.3 (33.5%)

Kenneth R. Dunmore is an Economist at Dale N. Hatfield Associates, Boulder, Colo.

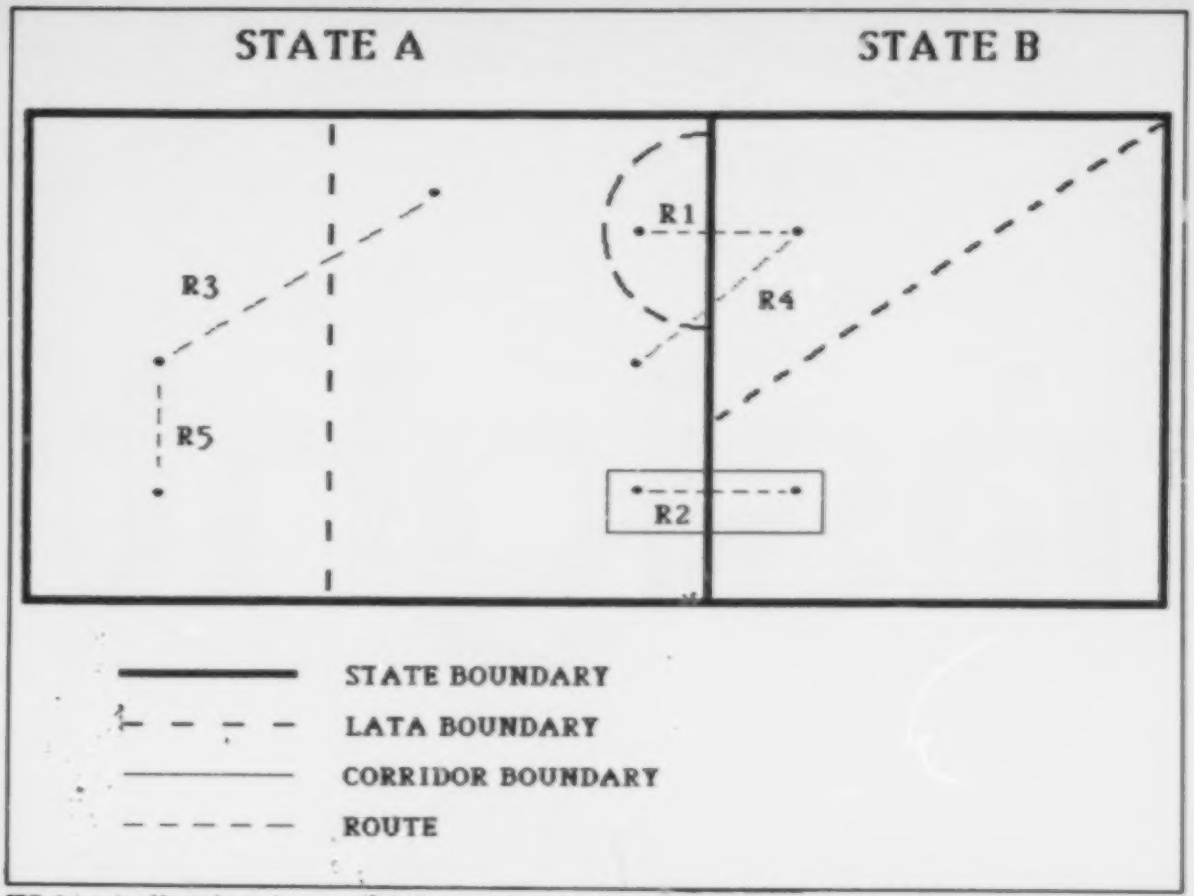

FIG. 1 *A pair of hypothetical states which illustrate the nature of the intra-LATA and inter-LATA markets.*

markets. Route R1 is an intra-LATA, interstate route, a stateline exception. Traffic along R1, which previously had been carried by members of the Bell System, now will be carried by a BOC. Route R2 is an inter-LATA, interstate corridor exception which is also served by the BOC. Route R3 is an inter-LATA, intrastate route, the first non-exception, and would be served by ATTC and any other IXCs which the state regulatory commission may certify. Route R4 is an inter-LATA, interstate route, which is the territory of the IXCs. Route R5 is an intra-LATA, intrastate route, which would be served, at least initially, by a BOC.

Regulation

There are still two regulatory jurisdictions as there were before divestiture. Now, however, the job of regulation is a bit more complicated; unless the regulatory authority deregulates as the Virginia commission recently did on intrastate, inter-LATA services. For the state regulators in particular, life has grown increasingly difficult. In a multiple LATA state, of which there are 39, the state commission must regulate at least two toll service providers; decide if additional competition, either [intra-LATA or inter-LATA] is warranted; and oversee the intrastate access charge structure.

In many multiple LATA states, the regulatory commission has decided to allow inter-LATA competition. Many state commissions are considering also permitting intra-LATA competition; in general, however, the commissions have rejected it. With the opening of the inter-LATA markets to competition and the continued resistance to competition in the intra-LATA markets, it is worthwhile to see what the stakes are in these markets.

Data on inter-LATA and intra-LATA markets are scarce, but there are enough to determine the size of each submarket relative to the total. Table 1, which is derived from a December 1983 Bell System monthly report, contains estimated message data for the MTS services provided by the old Bell-Independent partnership in December 1983.

Perhaps the most surprising aspect of the data is that the largest submarket is served by the BOCs. In fact, the MTS market that the BOCs can serve totals 48.7% of the total market. Since, in most states, intra-LATA competition still is now allowed, virtually half of the MTS market, as measured in message traffic,

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Table 2
Total toll revenues and distribution ($000,000)

	Intrastate	Interstate
Intra-LATA	$1976.3 (16.0%)	$ 155.9 (1.3%)
Inter-LATA	$2624.0* (21.3%)	$7570.3 (61.4%)

*Estimated

remains regulated as a monopoly.

Message data, however, cannot tell the whole story. In terms of revenues, intra-LATA services make up a much smaller part of the market. This difference, for the most part is due to the shorter lengths of intra-LATA traffic. Shorter calls have two distinguishing characteristics: shorter call durations and lower per minute rates.

Table 2 contains first quarter 1984 toll revenues by geographic submarket covering MTS, WATS and private line services reported by the BOCs and ATTC; the table was derived from BOC and ATTC quarterly reports.

The difference between the two sets of data is startling. Although the BOCs are allowed to serve nearly 50% of the message traffic, this traffic translates to a revenue share of only 17.3%, if interstate corridor traffic is not included. While this market segment totals more than $2 billion in revenue, it is a much smaller share than is indicated by the message data.

Corridor markets

Corridor traffic tends to be high density and short haul in nature. With rates based on average cost, corridor traffic should be highly profitable since its density will imply low costs per unit of traffic. The two corridors run between states and, as a consequence, their traffic and revenues are subsumed in the interstate, inter-LATA traffic reported earlier.

Due to the sharing arrangements between the BOCs providing interstate corridor services, it is not possible to precisely distinguish between the traffic and revenues of individual corridors. Interstate toll revenues for the three BOCs providing services in New York, New Jersey and Pennsylvania are estimated at $88.5 million for the first quarter of 1984, or 1.1% of the U.S. interstate toll market (the interstate, intra-LATA revenues of Bell of Pennsylvania however, have netted out of the total).

Implications

For the BOCs, the development of LATAs means restricted involvement in toll markets. Adding to this restriction from the FCC's Second Computer Inquiry and other requirements of the MFJ, future growth will be determined by the BOCs' ability to expand local and exchange access services. For AT&T, the market in terms of traffic and revenues is considerably larger as a result of divestiture than the previous market served by AT&T Long Lines to interstate and intrastate, inter-LATA services. AT&T's success in the intrastate markets will depend on its ability to keep competitors out and maintain its desired rates. Since both questions will be decided by state regulatory commissions, which are tough adversaries in most of the major states, the prognosis is not overly optimistic. Even so, in the high growth states in the South and Southwest, the regulatory climate is not considered very severe. Much of AT&T's growth at the intrastate level is likely to come in these states.

The other common carriers stand to gain the most from the formation of the new toll markets. With the BOCs more or less isolated from intrastate, inter-LATA markets, except for the provision of exchange access services, state commissions will be more receptive to certifying new carriers for inter-LATA service. Since these carriers have traditionally focused only on heavy route, interstate markets, the accessible market for them has effectively increased by 33% in terms of revenues and more than 50% in terms of traffic. □

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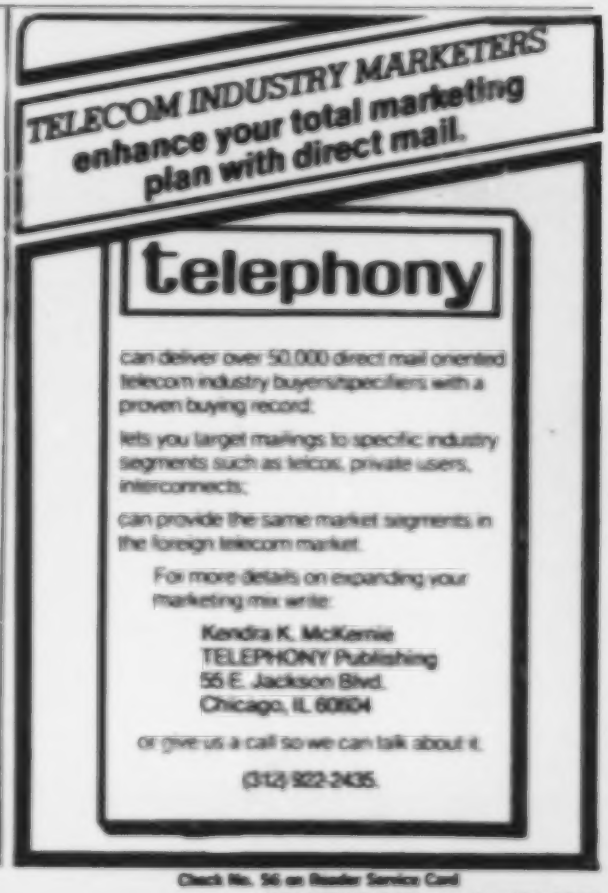
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